CORNERSTONE
Investment Management and Consulting

Expenses Matter!

A brief explanation of fees for mutual funds

One of the reasons Cornerstone Investment Management & Consulting was founded was to make costs clear in the investments industry. Often, investments products are sold, not bought. The simple fact is that companies charge exorbitant fees for some of their services because they can—investors have not been educated as to the true cost of their investments**. A 1% difference in investment return annualized over your lifetime can be the difference between a comfortable retirement and a worrisome one!**

Mutual funds are the most widely held investments in our country, and there are five potential charges associated with these investments. It is important that you understand these expenses and how they can affect the value of your account over time.

1) Front end loads -- when a stockbroker sells you a fund, you are charged a commission on that transaction; these often range from 5% to 5.75% of assets invested.

2) Back end loads – as an alternative to front-end loads, commissions can also be charged when you sell a fund; back-end loads typically start at 5% and decline by 1% each year after the second year that you have owned the fund (again, based on your assets in the fund). However, if this sounds like a great way to avoid paying up front, you might be surprised to know that total expenses are frequently higher on these funds, so you will actually pay more over time.

3) Marketing fees -- many mutual funds also have marketing fees you pay known as 12b-1 fees. This expense is assessed annually and provides the fund income for marketing and distribution. Often, a percent of this fee is provided to the broker who sold you the fund.

4) Management fee – this is the cost of the actual management of the assets on a day-by-day basis. For an actively managed equity mutual fund these charges average approximately 1.5% annually.

5) Trading costs -- investors are also charged for the trades conducted within the fund, the costs of which are very difficult to monitor. So, higher portfolio turnover likely means additional cost of investing.

When all of these expenses are taken together, the damage to your portfolio can be significant. To illustrate the point, we randomly selected a mutual fund with multiple classes of shares offered by a large brokerage house with fees that reasonably represent those charged across the industry. Let's assume the initial investment in the fund is $10,000 and the return for the next fifteen years is equivalent to the return of the last fifteen (12.21% on average for the S&P 500). After fifteen years, the ending value and expenses are as follows:

Class A shares – **Ending Value $44,474**, total fees over the period **$5155.09**
Front end load – 5.25% ($525 paid out before your money starts earning)
12b-1 fee -- .25%
Total expense ratio – 1.29%

Class B shares – **Ending Value $42,124**, total fees **$7256.52**
Back end load – 5% (not included because fund is assumed held for period)
12b-1 fee – 1%
Total expense ratio – 2.05%

Class C shares – **Ending Value $42,852**, total fees **$6905.06**
Back end load – 1% (not included because fund is assumed held for period)
12b-1 fee -- .25%
Expense ratio – 1.93%

There is a significant difference from among the returns for the same investment, and it is important that investors learn what to look for and the right questions to ask when selecting funds. It's **<u>time to take that 1% back</u>** by asking the right questions when presented with an investment idea:

What are the total expenses associated with this investment? Specifically, what are the charges on my investment for the following:

Front-end loads, back-end loads, 12b-1 fees, and management fees?

How are you compensated?

How do you analyze the mutual funds you offer?

How costly is it to get out of this investment?

Some helpful hints:

Avoid providers who do not answer these questions clearly and to your satisfaction.

Avoid anyone who tries to sell you class B shares of a mutual fund, especially if they tell you the funds are "no load".

Avoid working with someone who only offers you investment options from the company that they are representing.

To determine the costs of your investments:

You can use a couple of tools on the internet to determine the cost of your mutual funds. The steps to do so are:

1) Browse to www.morningstar.com – resource for mutual funds

Enter mutual fund ticker
Select "Fees & Expenses" tab on left
Record the following:
Initial Sales fee ___________
Deferred Sales fee ___________
Total expense ratio ___________

2) Browse to www.sec.gov – Securities & Exchange Commission

Select Calculators
Select Mutual Fund Cost Calculator
Run the JAVA script SEC Cost Calculator

Enter the following information (if you do not know, enter a reasonable guess):

Number of years you will hold investment (example 10)
Dollar value of initial investment (example $10,000)
Type of fund – (money market, fixed income (bonds), equity (stocks))
Expected rate of return
(8 – 10% is conservative for stocks, 6 – 7% is conservative for bonds)
Title (if desired)
Front end load (initial sales fee from above)
Back end load (deferred sales fee from above)
Conversion?
(include if you are provided this information, but you may omit)
Expense ratio (Total expense ratio from above)

The final results will provide the value of the position at the end of the period as well as the total expenses you will pay under the scenario you have entered. You can compare expenses across funds and classes of funds as well as truly see the impact that expense ratios can have upon returns. If you have questions about your mutual fund expenses, please contact us and ***consider Cornerstone your resource for unbiased market information.***